wholesale shifting of billions of dollars in industry cost recovery from carriers to end users than an evaluation of "benefits" between the calling and the called party. Any evaluation of benefits in this area is unverifiable. It is no accident that the OPP Papers provided no empirical evidence supporting their evaluation of benefits, because none is available. The prospect of the major real world changes contemplated in the *Intercarrier Compensation NPRM* being implemented on the basis of theoretical, unverifiable evaluations of benefits is disconcerting.

Moreover, there is no reason to believe that the OPP Papers are correct in their assignment of benefits between calling and called parties. As explained in the *ETI Report,* it is more reasonable to assume that the calling party benefits more.[91] Thus, the calling party selects who to call, the time of the call, and the subject of the call. In contrast, the called party does not choose the time of the call, does not know the subject of the call, and does not know what the call will cost. When the call is not answered, or not completed because the line is busy, the called party receives no benefit. And, of course, throwing unsolicited calls into the equation, which would increase under bill-and-keep and which many consumers do not view as conferring any benefit, the more reasonable conclusion is that overall the calling party benefits more. Therefore, even assuming that "benefits" is an appropriate basis for establishing intercarrier compensation schemes, which it is not, there is no reason to accept the conclusions of the OPP Papers in this regard.

However, the OPP Papers also err in assuming that efficient pricing or assignment of responsibility should track benefits of calls. As explained in the *ETI Report,* there is no

91 *See ETI Report* at 46-47

economic "efficiency" theory requiring that payment responsibility follow benefits.[92] Accordingly, the "benefits" approach of OPP Papers is an unacceptable basis for crafting a new scheme of intercarrier compensation. Since this approach appears to be the theoretical basis for adopting bill-and-keep, the OPP Papers provide no basis for implementing that scheme of intercarrier compensation.

B. The Suggested Treatments of Transport Costs Would Harm CLECs

The intercarrier compensation proposals in the OPP Papers should also be rejected because the allocations of transport obligations would be unworkable. In the event that an ILEC and a CLEC were unable to agree on transport obligations, the default rules that would apply under both COBAK and BASICS would harm CLECs by shifting most of the costs of transport to them.

The COBAK proposal simply ignores the fact that CLEC networks may use long-loops or fiber rings in place of the tandem switches deployed by ILECs.[93] Thus, delivery of a call to the CLEC central office may often be the functional equivalent of delivering a call to the ILEC tandem office. Unlike the ILEC that has a relatively short transport obligation after receiving traffic at its end office, the CLEC may have to transport traffic all the way across its network

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92 *Id.* at 47.

93 Even though COBAK is founded on the principle that the calling party and the called party share the benefits of a call equally, COBAK departs from this principle with respect to transport. Under COBAK, the originating party pays for all transport to the terminating central office; thus, the cost for the call is borne disproportionately by the calling party. Although the author of COBAK admits that this solution is a pragmatic resolution of allocating transport obligations, this position completely invalidates any theoretical basis for COBAK that assumes both parties benefit equally from a call between them. *ETI **Report*** at **48.**

after accepting traffic at its central office. Unless the CLEC were somehow compensated for the use of its long loops or fiber rings, the CLEC would often be undercompensated in a COBAK arrangement. To achieve a level of comparability, the Commission would need to adopt a regime in which the CLEC transport obligation would end at the nearest ILEC tandem office.

Under the BASICS proposal, the new market entrant would be obligated to compensate the ILEC for a share of the incremental costs of interconnection; in other words, the CLEC must pay the ILEC in order to bring the CLEC network up to the ILEC network. The CLEC would be compelled to establish multiple points of interconnection with the incumbent, thereby shifting the transport obligation onto the CLEC for traffic that it originates and terminates.[94] Shifting these costs onto a new market entrant would only make interconnection more expensive, and thereby discourage new market entry.[95]

IX. THE COMMISSION SHOULD RETAIN CPNP FOR ALL TRAFFIC

A. CPNP for ISP-Bound Traffic Maximizes Economic Efficiency and Provides ILECs with Proper Incentives

Instead of establishing bill-and-keep for any category of traffic, the Commission should more thoroughly implement CPNP to address the perceived current "problems." With respect to ISP-bound traffic, as noted, the *Local Competition Order* established the appropriate framework.

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94 *Id.* at 48-49.

95 For an overall critique of the OPP Papers, including an analysis of their principal weaknesses, see *ETI Report* at 37-53.

There, the Commission correctly determined that symmetrical reciprocal compensation rates would be based on ILEC costs using a forward-looking incremental cost methodology.[96]

As also noted, ILEC unhappiness with this framework is attributable entirely to their own insistence on high reciprocal Compensation rates and to the fact they have failed to establish reciprocal compensation rates based on the most efficient technologies available, preferring for the most part simply to retain legacy networks. If ILECs had responded to the strong incentives established by Congress in the reciprocal compensation provision by building the advanced data capabilities envisioned in the Telecom Act, they would not be importuning the Commission to protect them from competition. Thus, instead of bill-and-keep, the Commission should affirm, and, to the extent necessary, return to the framework of the *Local Competition Order*. The recent *Collocation Remand Order* may provide guidance to the Commission wherein the Commission determined that in certain respects since the *Local Competition Order* it had overreached.[97]

Assuming *arguendo* that there is a "problem" with intercarrier compensation for ISP-bound traffic, the proposed solution is wrong. In the *ISP Traffic Remand Order*, the Commission suggested that it must abolish intercarrier compensation for ISP-bound calls because "the market distortions caused by applying a CPNP regime to ISP-bound traffic cannot be cured by regulators

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[96] *Local Competition Order* at ¶ 1085.

[97] *In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147, Fourth Report and Order (rel. Aug. 8,2001) *("Collocation Remand Order").*

or carriers simply attempting to 'get the rate right.'"[98] In the *ISP Trafic Remand Order,* the Commission stated,

> Contrary to the view espoused by CLECs, we are concerned that the market distortions caused by applying a CPNP regime to ISP-bound traffic cannot be cured by regulators or carriers simply attempting to "get the rate right." A few examples may illustrate the vexing problems regulators face. Reciprocal compensation rates have been determined on the basis of the ILEC's average costs of transport and termination. These rates, do not, therefore reflect the costs incurred by any particular carrier for providing service to a particular customer. This encourages carriers to target customers that are, on average, less costly to serve, and reap a reciprocal compensation windfall."

It is surprising that the *NPRM* would now find intercarrier compensation payments based on average costs so troubling since the Commission has been employing average cost pricing since 1934. More importantly, apart from the fact that bill-and-keep for this traffic is unlawful, the *ISP Trafic Remand Order* totally failed to recognize that setting a reciprocal compensation rate based on ILEC average costs provides a level playing field in which both ILECs and CLECs can seek to benefit by becoming more efficient than what is implied in the ILEC rate. As noted in the *ETI Report,* using CLEC costs would produce a skewed result because of the disparity in economies of scale between CLECs and ILECs. Although CLECs have more efficient networks, one can expect CLEC cost studies to generate higher network element rates than those generated by ILEC cost studies.'"

The approach of the *Local Competition Order* places ILECs and CLECs in exactly the same situation in that both can construct the new networks and facilities that will produce more

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98 *ISP Trafic Remand Order* at **¶ 76.**

99 *Id.*

profits and better service to consumers. In effect, establishing bill-and-keep, as noted, simply rewards ILECs in their status as incumbents by saying that they do not need to construct new networks in order to become more efficient and thereby, to set the groundwork for a lower symmetrical reciprocal compensation rate."[100] In this respect, bill-and-keep insulates ILECs from the competitive pressure that Congress intended in Section 251(b)(5).

In contrast, of course, CLECs do not enjoy the benefits of incumbency. They have gone to the capital markets and have built networks, and some are now facing difficulties because of the risk entailed in doing so. (By contrast, the ILECs faced virtually no investment risk when they built their networks because of their monopoly status and guaranteed rates of return on their investment.) Again, ILECs could have also built new, more efficient networks that could produce the lower reciprocal compensation rates that they would like to impose on CLECs, but they did not, and would prefer that the Commission simply abolish the reciprocal compensation requirement that would otherwise motivate them to do so. ILECs have also preferred to overstate their costs of transport and termination because a realistic assessment of those costs would provide compelling evidence that their interstate and intrastate access charges are grossly

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100 *ETI* ***Report*** at ***30.***

101 The Commission recognizes that reciprocal compensation rates must keep up with the technology: "We do not suggest that it costs CLECs less to serve ISPs than other types of customers. New switching technologies make it less costly to serve *all* customers. If, however, costs are lower than prevailing reciprocal compensation rates, then CLECs are likely to target customers, such as ISPs, with predominantly incoming traffic, in order to maximize the resulting profit." *ISP Traffic* ***Remand Order*** at n. 168. Accordingly, ILECs have a very strong incentive to build more efficient networks – as CLECs have already done – in order to minimize their reciprocal compensation obligations.

inflated. The Commission should not impose a result that harms CLECs because of the questionable business decisions of their incumbent competitors.

In addition, the proposed bill-and-keep solution to the "problem" of intercarrier compensation for ISP-bound calls relies on an assumption that is directly contradicted elsewhere in the *ISP Traffic Remand Order.* This order assumes that there are customers that are "less costly to serve" and that these customers represent a potential windfall to competitors. When one actually considers what carriers are being compensated for when they are paid reciprocal compensation, it is clear that bill-and-keep is not the appropriate solution to the perceived "problem." Reciprocal compensation is paid for the transport and termination of telecommunications.[102] Transport is defined as transport from the point-of-interconnection ("POI") to the terminating carrier's switch.[103] Termination is defined as the switching function and delivery of the call from the switch to the called party's premises.[104] Even though the definition suggests that loop costs may be included in the termination function, they are not part of the reciprocal compensation rate that is set using the ILEC's costs.[105] The Commission explicitly recognizes this point in the *ISP Traffic Remand Order:*

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102 47 U.S.C. § 251(b)(5).

103 47 CFR §51.701(c).

104 47 CFR § 51.701(d).

105 ***Local Competition Order*** at ¶ 1057. For this reason, the fact that ISPs may collocate in CLEC central offices is not relevant to whether reciprocal compensation for service to ISPs represents a potential windfall. Whether the length of the facility serving an end user is 100 miles or 100 feet, the cost of that facility is not included in the ILEC-based reciprocal compensation rate paid for transport and termination.

> Ameritech maintains that it costs CLECs less to deliver ISP-bound traffic than it costs incumbent LECs to deliver local traffic because CLECs can reduce transmission costs by locating their switches close to ISPs. The proximity of the ISP or other end-user to the delivering carrier's switch, however, is irrelevant to reciprocal compensation rates. The Commission concluded in the *Local Competition Order* that the non-traffic sensitive cost of the local loop is not an "additional" cost of terminating traffic that a LEC is entitled to recover through reciprocal compensation.[106]

Therefore, a customer can be "less costly to serve" in terms of reciprocal compensation only if there is some aspect of service to that customer that distinguishes the switching function provided to it from that provided to a customer with "average" traffic.

In fact, the *ISP Traffic Remand Order* itself confirms "the view espoused by CLECs" that ISPs are not "less costly to serve" than an average end user. According to the Commission,

> The record in response to the *Intercarrier Compensation NPRM* and the *Public Notice* fails to establish any inherent differences between the costs on any one network of delivering a voice call to a local end-user and a data call to an ISP. Assuming the two calls have otherwise identical characteristics (e.g., duration and time of day), a LEC generally will incur the same costs when delivering a call to a local end-user as it does delivering a call to an ISP.[107]

Thus, there is no reason to compensate ISP-bound traffic any differently than any other type of traffic.

The rationale in the *NPRM* for adopting bill-and-keep for ISP-bound traffic – namely, that CPNP will allow carriers to reap windfalls because some customers are "less costly to serve" – is completely undermined in the *ISP Traffic Remand Order* by the finding that a correctly devised rate structure eliminates the possibility that some customers are "less costly to serve":

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106 *ISP Traffic Remand Order* at ¶ 92.

107 ***Id.*** at ¶ 90 (emphasis added).

> We are not persuaded by commenters' claims that the rates for delivery of ISP-bound traffic and local voice traffic should differ because delivering a data call to an ISP is inherently less costly than delivering a voice call to a local end-user. In an attached declaration to Verizon's comments, William Taylor argues that reciprocal compensation rates may reflect switching costs associated with both originating and terminating functions, despite the fact that ISP traffic generally flows in only one direction. If correct, however, this observation suggests a need to develop rates or rate structures for the transport and termination of *all* traffic that exclude costs associated solely with originating switching."[108]

Thus, the solution is not the adoption of bill-and-keep. Instead, it is the adoption of a rate structure that more accurately reflects the way costs are incurred. The Commission also recognized this principle:

> Mr. Taylor similarly argues that ISP-bound calls generally are longer in duration than voice calls, and that a per-minute rate structure applied to calls of longer duration will spread the fixed costs of these calls over more minutes, resulting in lower per-minute costs, and possible over recovery of the fixed costs incurred. **Any** possibility of over recovery associated with calls (to ISPs or otherwise) of longer than average duration can be eliminated through adoption of rate structures that provide for recovery of per-call costs on a per-call basis, and minute-of-use costs on a minute-of-use basis. We also are not convinced that ISP-bound calls have a lower load distribution (*i.e.,* number and duration of calls in the busy hour as a percent of total traffic), and that these calls therefore impose lower additional costs on a network. It is not clear from the record that there is any "basis to speculate that the busy hour for calls to ISPs will be different than the CLEC switch busy hour," especially when the busy hour is determined by the flow of both voice and data traffic."[109]

Thus. it could not be clearer that the *NPRM*'s premise that bill-and-keep is necessary to avoid the ability of carriers to "reap a reciprocal compensation windfall" is incorrect.

The Texas Public Utility Commission has also considered the issue of whether it is less costly to serve ISPs. It concluded that ISPs are not necessarily less costly to serve for the

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108 *Id.* at ¶ 91 (emphasis added).

109 *Id.* (emphasis added)

purposes of reciprocal compensation.[110] In framing the issue, the Texas PUC stated, "SWBT notes that a principal reason that it is less costly to terminate an ISP-bound call than a voice call is the longer average hold time."[111] According to SWBT, the average duration of a voice call was 3 minutes in its cost study, but the average duration of an ISP-bound call was 29 minutes. The longer duration of the ISP-bound call requires far fewer call set-up and call tear-down costs than were factored into the Texas reciprocal compensation rate.[112] This was remedied by the Texas PUC by bifurcating the reciprocal compensation rate into a per-call set-up charge and a per-minute duration charge. The Texas PUC was thereby able to eliminate whatever economic distortions may have occurred as a result of the longer duration of ISP-bound calls. In any event, this approach disproves the assumption in the *NPRM* and in the *ISP Traffic* Remand Order that the variability inherent in service to a subsection of end users justifies eliminating the CPNP regime and adopting bill-and-keep.[113]

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110 Proceeding to Examine Reciprocal Compensation Pursuant to Section 252 of the Federal Telecommunications Act of *1996*, Docket No. 21982, Arbitration Award (Tex. PUC July 13, 2000) at 47.

111 *Id.* at 43.

112 ***Id.***

113 Throughout its 13-state service territory, SBC apparently has subscribed to the idea that a bifurcated reciprocal compensation rate remedies whatever economic distortions may exist as a result of the payment of reciprocal compensation. In its new "Reciprocal Compensation Appendix'' to its interconnection agreement template, SBC elects not to adopt the federal intercarrier compensation regime for ISP-bound traffic. Instead, SBC offers to pay a bifurcated reciprocal compensation rate for all traffic, including ISP-bound traffic. The Reciprocal Compensation Appendix is available at **https://clec.sbc.com/unrestr/interconnect/** multi/index.cfm.

The *ISP Traffic* ***Remand Order*** also suggests that bill-and-keep is necessary to avoid a flight of CLECs to those customers "less costly to serve" and implies that an individual carrier's costs must be determined if regulators are to get the rate right.[114] The Commission cited the impracticality of such a proposal as a justification for imposing bill-and-keep on the transport and termination of ISP-bound traffic.[115] In fact, it is not necessary to consider each and every individual carrier's costs in order to establish reasonable terminating compensation rates that eliminate so-called market distortions. As noted, rates based on ILEC costs will provide an incentive to ILECs to build more efficient networks in order to reduce their reciprocal compensation obligations. This approach, if the Commission would stick with it, would provide the best way to address any concerns about cost-based rates for reciprocal compensation.

In short, bill-and-keep is the entirely wrong solution to the "problem" of intercarrier compensation for ISP-bound traffic that the ***NPRM*** perceives. Instead of the strained interpretations of the Telecom Act, such as the recent finding that ISP-bound traffic constitutes "information access" that attempts to rewrite Section 251(b)(5), the Commission should fully embrace the framework of the ***Local Competition Order.*** For all the reasons stated herein, this would best produce the competitive environment Congress intended in the Telecom Act.

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114 *ISP Traffic* ***Remand Order*** at ¶ ***76.***

115 ***Id.*** at ¶ **76.**

B. The Commission Should Not Mandate Interconnection In Each ILEC-Defined Local Calling Area

1. The Commission Should Retain the Single-POI-per-LATA Requirement

The proposals to implement bill-and-keep should also be rejected because they would apparently mandate inefficient interconnection requirements. The Commission should retain the current rule that permits a CLEC to designate a single point in each LATA to interconnect with the incumbent while permitting carriers to negotiate additional POIs based upon sound engineering principles and traffic volumes.

When transport was more expensive than it is now and switches had less capacity than they do now, carriers would deploy multiple switches within a particular geographic region. Switches would be connected to each other through tandem switches. The telecommunications network largely assumed a hub-and-spoke architecture in which the tandem switches were the hubs and the end offices were at the ends of the interoffice transport "spokes." At the time, this was the most efficient way to provide ubiquitous coverage and interconnectivity. For the purposes of this description, we can assume that a single tandem-to-end-offices hub-and-spoke arrangement would cover a single ILEC-defined local calling area, and a call that involved transport between tandem switches would qualify as a toll call.

With the advent of fiber optic technologies, however, transport costs have been dramatically reduced. Further, switching technology has become more efficient. As a result, a single switch connected to fiber-optic transport can serve geographic areas comparable to the areas previously served by tandem switches connected to end-office switches. For example, by deploying fiber-optic transport in a ring around a large geographic area, with its switch on one

point on the ring and the POI with the ILEC on another point on the ring, a CLEC can serve multiple ILEC-defined local calling areas from a single switch.[116] Customers throughout the area served by the ring can obtain service from the CLEC by being connected to the ring, and any traffic carried over the ring can be handed over to the ILEC at the POI for termination on the ILEC network.

However, under the bill-and-keep proposals being considered by the Commission, CLECs would be required to abandon their efficient network by establishing POIs in each ILEC-defined local calling area. CLECs can service customers efficiently without deploying multiple switches or POIs across a wide geographic area, and should not be required to do so. Thus, like the other proposals in the *NPRM*, CLECs would be penalized for their success in building efficient networks by making them mimic ILEC networks and calling areas. In fact, as discussed in the *ETI* ***Report,*** there is no economic or other basis for making CLECs duplicate ILEC-defined local calling areas.[117] Accordingly, the Commission should not require CLECs to interconnect in each ILEC-defined local calling area, and the rule permitting a single POI per **LATA** should be retained. The better approach is to leave interconnection arrangements to negotiation between the parties, based on sound engineering principles subject to the single-POI-per-LATA default rule.

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116 Obviously, this more advanced technology further blurs the distinction between local traffic and toll traffic. ***See*** discussion ***supra,*** Section IV.D.

117 *ETI* ***Report*** at ***49-53.***

2. The Use of Virtual Central Office Codes by CLECs Does Not Justify Requiring More Than One Interconnection Point per LATA

The use of virtual central office codes (NXX codes) by CLECs appears to be the primary motivating factor for possible revision of the single POI requirement. The practice of using central office codes to serve customers that are not physically located in the ILEC-defined local calling area associated with the central office code is an unexceptional practice. ILECs have provided "foreign exchange" services for years. CLEC use of virtual central office codes is a competitive response to ILEC practices.

CLECs serving ISPs began implementing virtual NXX services in response to Bell Atlantic's provision of a product called Wide Area FlexPath, Ameritech's provision of a service called Ensemble or Omnipresence, and now Verizon's CyberPOP service."[118] Wide Area FlexPath is a service offered to ISPs by the Bell Atlantic Verizon companies that allows ISPs to establish a

[118] *Investigation into the Acquisition and Use of Central Office Codes by Local Exchange Carriers in Vermont,* Docket No. 6209, Order Opening Investigation and Notice of Hearing (Vt. Pub. Svc. Bd. Mar. 25, 1999); http://www.ameritech.com/ucontent/l,4674,278,00.html ("Omnipresence uses the Ameritech network to provide a virtual presence in multiple locations for your business. For example, you are located in Chicago but want to provide local telephone numbers to locations outside the city so customers can call without incurring local toll charges. Omnipresence allows you to provide local numbers without having to invest in space or equipment at each dial-up location."); http://www.sbc.com/ISP/0,2959,00.html ("ENSEMBLE is a single Point-of-Presence (POP) solution that allows you to provide your customers with local access within the Ameritech-served areas of a specific LATA. You can set up dial-up phone numbers for your subscribers within a designated LATA using a single POP. Without the need for multiple POPs, your cost savings will grow."); http://www22.verizon.com/wholesale/attachents/5924D.PDF ("Addressing the challenge of connecting subscribers to the Internet using local connections, Verizon's CyberPOP platform gives ISPs points-of-presence in Verizon Central Offices to provide a fast, cost-effective means for meeting the growing demands in your service areas. Expanding into new markets for increased profitability and a broader reach goes from possible to probable, because CyberPOP leverages Verizon's national footprint to build your presence in the marketplace without your having to own or maintain equipment and staff a new facility.")

single physical location to terminate inbound dial-up traffic, but provides them with telephone numbers located throughout Bell Atlantic's service territory. End users can place calls to the ISP that are rated as local calls even though the ISP's modem facilities are located in another local calling area. The same is true for the Ensemble/OmniPresence and CyberPOP products. Competitive necessity required CLECs serving ISPs to make a comparable virtual NXX service available. This was accomplished by obtaining NXX codes for ILEC-defined local calling areas to allow their ISP customers to establish a "virtual" local presence there. (The presence is "virtual" insofar as one believes that CLECs must adhere to the local calling areas defined by the ILECs.) Calls placed to those numbers are rated by the ILEC as local calls, exchanged with the CLEC at the POI, and terminated at the ISP by the CLEC. As local calls, they also are subject to reciprocal compensation under the interconnection agreements between the ILEC and the CLEC.

It is important to note that the originating carrier's switching and transport obligation is the same whether or not virtual central office codes are used by the terminating carrier. Since the originating carrier is required to switch and transport all traffic to the POI with the terminating carrier, the physical location of the terminating carrier's customer has no relevance to the level of transport the originating carrier must provide to complete the call. For this reason, the originating carrier should be completely indifferent as to where the terminating carrier's customer is located. Therefore, it makes no sense to require the terminating carrier to establish a POI in every ILEC-defined local calling area where it has an NXX code homed.

Further, the entire discussion of the use of "virtual central office codes" begins from the questionable premise that CLECs must follow ILEC-defined local calling areas in the provision of their own competitive services. As discussed above, ILEC-defined local calling areas are an

anachronism that is neither required nor appropriate in the contemporary telecommunications market."' Just as it makes no sense now to require carriers to establish interconnection arrangements on the basis of an essentially outmoded distinction between local traffic and toll traffic,[120] the idea that CLEC customers must establish "virtual" a presence anywhere is equally anachronistic. CLECs should be allowed to define the boundaries of calling areas in which inbound calls would be rated as local just as much as they define boundaries of calling areas in which outbound calls are rated as local.[121] Thus, there should be no change to the existing requirement that a CLEC must establish only a single POI per LATA. The rule provides an excellent baseline from which carriers may negotiate alternate transport arrangements based upon sound engineering and economic principles.

3. Intercarrier Compensation For Transport And Termination Of Virtual Central Office Code Traffic To ISPs Is Governed By The *ISP Traffic Remand Order.*

If the Commission correctly determines not to adopt the bill-and-keep proposals that would require CLECs to establish multiple points of interconnection with the ILEC, the Commission need go no further than ruling that it will retain the requirement that a CLEC may designate a single POI per LATA with the incumbent. To the extent that the Commission addresses the interconnection and transport issues any further in this proceeding, it must make clear that these issues are governed by sections 251(a), (b) and (c) of the Telecom Act, and are

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119 *ETI* ***Report*** at 52.

120 ***Id.*** at 50-53.

121 ***Id.*** at 51.

unrelated to Section 251(b)(5) reciprocal compensation or so-called Section 251(g) "information access" intercarrier compensation.

In any event, the issue of intercarrier compensation for the transport and termination of traffic to ISPs using virtual central office codes is governed by the terms of the ISP ***Traflc Remand Order.*** The Commission did not distinguish between types of ISP-bound traffic, but instead ruled that all ISP-bound "information access" traffic is subject to the federal regime established in that Order. Therefore, with respect to intercarrier compensation for the transport and termination of ISP-bound traffic, it makes no difference whether a terminating carrier uses virtual central office codes to provide service. All ISP-bound information access traffic is compensated at the applicable rates under the federal regime in the ISP ***Traflc Remand Order,*** and the *NPRM* provides no reason to vary from that result for virtual central office code traffic.

C. The Commission Should Reject Arbitrary Traffic-Exchange Ratios in a CPNP Regime

In the ISP *Traffic* ***Remand Order,*** the Commission adopted **a** compensation regime in which, once a terminating carrier's traffic volume exceeds a fixed **3:** 1 ratio of outbound calls to inbound calls, the terminating carrier would be paid at a rate significantly lower than state-approved rates for reciprocal compensation based on ILEC costs.[122] Going forward, the Commission should reject such arbitrary thresholds because they are ***per se*** discriminatory against carriers that serve customers with predominantly inbound traffic, and they have no sound

[122] ISP ***Traflc Remand Order*** at ¶ 79.

economic justification.[123] These arrangements serve only to limit the amount of terminating compensation a carrier may receive, without regard to whether the above-ratio rate reflects the costs incurred by the terminating carrier. They also inappropriately assume that unbalanced traffic flows should be discouraged, and should be corrected through regulatory dictates.[124] Because there is no principled reason to impose such restrictions on terminating compensation, compensation thresholds based upon traffic-exchange ratios should be rejected.

X. CONCLUSION

The so-called "problems" that the ***Intercarrier Compensation NPRM*** purports to fix are in fact little more than nascent competition in action. The Commission established a set of ground rules in the *Local* ***Competition Order*** to handle these new markets that the Commission need not second-guess. Chief among these ground rules was the proper conclusion that bill-and-keep may not be imposed between two carriers unless traffic exchanged between them is roughly in balance. The Commission was right then, and there is no need to revisit that conclusion. When more thoroughly implemented, that is, when terminating compensation rates (for both exchange access and telephone exchange service, including ISP-bound traffic) are set at the forward-looking economic cost of the ILEC, the rules from the *Local* ***Competition Order*** will resolve any short-term problems related to intercarrier compensation. The negative consequences and impracticality of the alternative are so overwhelming as to require the immediate rejection of

123 ***ETI Report*** at 54-59.

124 ***Id.*** at 59.

mandatory bill-and-keep. The complete upheaval of industry practice, as well as the shifting of billions of dollars in cost recovery from carriers to end users, should not be seriously considered. For the reasons stated herein, the proposals in the *NPRM* to adopt a bill-and-keep regime as the basis for intercarrier compensation should be abandoned.

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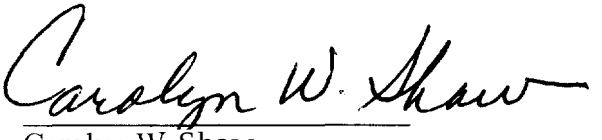

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EFFICIENT INTERCARRIER COMPENSATION MECHANISMS FOR THE EMERGING COMPETITIVE ENVIRONMENT

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Preface

EFFICIENT INTERCARRIER COMPENSATION MECHANISMS FOR THE EMERGING COMPETITIVE ENVIRONMENT

When the ***Telecommunications Act*** of *1996* opened the nation's local exchange markets to competition as a legal matter, one of the key implementation challenges was to devise fair and efficient financial arrangements between interconnecting incumbent local exchange carriers (ILECs) and the new competitive LECs (CLECs). The "reciprocal compensation" payments system that was implemented has become increasingly controversial, as some CLECs have pursued niche markets, notably the market for Internet Service Providers and other users with high volumes of inward calling. In December 2000, the FCC's Office of Plans and Policy (OPP) released two working papers by FCC economists that attempt to provide a theoretical foundation to replace the reciprocal compensation system with a so-called "bill-and-keep" regime, in which each LEC would assume responsibility for the costs of terminating calls to its end users. In April 2001, the FCC adopted an Order that carved out ISP-bound calls from other forms of locally-rated calling for intercarrier compensation purposes, and adopted an accompanying ***Notice*** of ***Proposed Rulemaking*** that seeks to impose bill-and-keep arrangements upon those calls and possibly for other types **of** exchanged traffic as well.

Economics and Technology, Inc. has been asked by Pac-West Telecomm, Inc., Focal Communications Corporation, and **US** LEC Corp. to undertake a comprehensive examination of the reciprocal compensation issue and, in particular, the recently published "bill-and-keep" proposals advanced by the FCC's Office of Plans and Policy. The project was conducted under the overall direction of Dr. Lee L. Selwyn and Scott C. Lundquist. Contributing to this work were Anne **M.** Dupree and Jillian **P.** Jewett. The views expressed **in** this study are those of ETI, and do not necessarily reflect the views of its sponsors.

August 2001

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